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SUBJECT: MEXICO'S 2008 INVESTMENT CLIMATE STATEMENT -- PART 1 OF 2

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This part one of a two part cable that provides text for the 2008 Mexico Investment Climate Statement.

Openness to Foreign Investment

Mexico is open to foreign direct investment (FDI) in most economic sectors and has consistently been one of the largest recipients of FDI among emerging markets. In recent years, Mexico has become increasingly aware of its loss of competitiveness relative to other emerging economies, notably China and India, as it had failed to address serious crime and safety issues or pass much needed reforms. Recent government efforts against organized crime, as well as successes in the reform agenda, have improved business confidence, underpinning increases in foreign investment. Mexico will have to continue this progress to regain competitiveness as a FDI destination, particularly for non-U.S. investors.

Foreign investment in Mexico has largely been concentrated in the northern states close to the U.S. border where most maquiladoras are located, and in the Federal District (Mexico City) and surrounding states. The Yucatan peninsula, historically an area for tourism investment, has seen industry in other sectors grow due in part to the ability to quickly send goods from its ports to the United States. Financial services, automotive and electronic sectors have received the largest amounts of FDI. Historically, the United States has been the largest source of FDI in Mexico. As of September, U.S. investors had provided 50.4 percent of 2007 FDI.

On June 13, 2007, President Calderon created ProMexico, a federal entity charged with promoting Mexican exports around the world and attracting foreign direct investment to Mexico. Through ProMexico, federal and state government efforts as well as related private sector activities, are coordinated with a goal of harmonizing programs, strategies and resources aimed at common objectives and priorities while supporting the globalization of Mexico's economy. ProMexico maintains an extensive network of offices abroad as well as a multi-lingual website (http://www.investinmexico.com.mx) which provides information on establishing a corporation, rules of origin, labor issues, owning real estate in Mexico, the maquiladora industry, and sectorial promotion plans, among other topics.

The Secretariat of Economy (SECON) also maintains a bilingual

website (www.economia.gob.mx) offering an array of information, forms, links and transactions. Among other options, interested parties can download import/export permit applications, make on-line tax payments, and chat with on-line advisors who can answer specific investment and trade related questions. State governments have also passed small business facilitation measures to make it easier to open businesses.

Despite progress however, according to a World Bank study, it takes on average 27 days to complete all paperwork required to start a business in Mexico; compared to an average OECD figure of 15 days. The Embassy advises potential investors to contact ProMexico for detailed information on investing in Mexico.

The 1993 Foreign Investment Law is the basic statute governing foreign investment in Mexico. The law is consistent with the foreign investment chapter of NAFTA (the North American Free Trade Agreement). It provides national (i.e. non-discriminatory) treatment for most foreign investment, eliminates performance requirements for most foreign investment projects, and liberalizes criteria for automatic approval of foreign investment.

The Foreign Investment Law identifies 704 activities, 656 of which are open for 100 percent FDI stakes. There are 18 activities in which foreigners may only invest 49 percent; 13 of which require Foreign Investment National Commission approval for a 100 percent stake; 5 reserved for Mexican nationals; and 10 reserved for the Mexican state. Below is a summary of activities subject to investment restrictions.

TABLE I

SECTION 1: SECTORS RESERVED FOR THE STATE IN WHOLE OR IN PART:

A) Petroleum and other hydrocarbons;
B) Basic petrochemicals;
C) Telegraphic and radio telegraphic services;
D) Radioactive materials;
E) Electric power generation, transmission, and distribution;
F) Nuclear energy;
G) Coinage and printing of money;
H) Postal service;
I) Airports;
J) Control, supervision and surveillance of ports and heliports.

SECTION 2: SECTORS RESERVED FOR MEXICAN NATIONALS:

A) Retail sales of gasoline and liquid petroleum gas;
B) Non-cable radio and television services;
C) Credit Unions, Savings and Loan Institutions, and Development Banks;
D) Certain professional and technical services;
E) Domestic transportation for passengers, tourism and freight, except for messenger or package delivery services.

U.S. and Canadian investors generally receive national and most-favored-nation treatment in setting up operations or acquiring firms. Exceptions exist for investments for which the Government of Mexico recorded its intent in NAFTA to restrict certain industries to Mexican nationals. U.S. and Canadian companies have the right under NAFTA to international arbitration and the right to transfer funds without restrictions. NAFTA also eliminated some barriers to investment in Mexico, such as trade balancing and domestic content requirements. Local governments must also accord national treatment to investors from NAFTA countries. Mexico is also a party to several OECD agreements covering foreign investment, notably the Code of Liberalization of Capital Movements and the National Treatment Instrument.

Approximately 95 percent of all foreign investment transactions do not require government approval. Foreign investments requiring applications and not exceeding USD 165 million are automatically approved, unless the proposed investment is in a sector subject to restrictions by the Mexican constitution and Foreign Investment Law that reserve certain sectors for the state and Mexican nationals (see Table 1). The National Foreign Investment Commission determines whether investments in restricted sectors may go forward and has 45 working days to make a decision. Criteria for approval include employment and training considerations, technological contributions, and contributions to productivity and competitiveness. The Commission may reject applications to acquire Mexican companies for national security reasons. The Secretariat of Foreign Relations (SRE) must issue a permit for foreigners to establish or change the nature of Mexican companies.

Despite Mexico's relatively open economy, a number of key sectors in Mexico continue to be characterized by a high degree of market concentration. For example, the telecommunications, electricity, television broadcasting, petroleum, beer, and tortilla sectors feature one or two or several dominant companies (some private, others public) with enough market power to restrict competition. The Mexican Congress strengthened the enforcement powers of the Federal Competition Commission (CFC) in 2006 and is considering stiffer penalties for anti-competitive conduct, but the CFC remains weak relative to its OECD counterparts in terms of enforcement. CFC Commissioner Eduardo Perez Motta and leading members of the Calderon Administration, including the President, have publicly committed to opening up the Mexican economy to greater competition. For more information on competition issues in Mexico visit CFC,s bilingual website at: www.cfc.gob.mx

Energy

The Mexican constitution reserves ownership of petroleum and other hydrocarbon reserves for the Mexican state. Oil and gas exploration and production efforts are under the sole purview of Pemex, Mexico's petroleum parastatal. The constitution also provides that most electricity service may only be supplied by two state-owned companies, the Federal Electricity Commission (CFE) and Central Power and Light

(LYFC). There has been some opening to private capital. Private electric co-generation and self-supply are now allowed. Private investors may build independent power projects but all of their output must be sold to CFE in wholesale transactions. Private construction of generation for export is permitted. In 1995, amendments to the Petroleum Law opened transportation, storage, marketing and distribution of natural gas imports and issued open access regulations for Pemex's natural gas transportation network. Retail distribution of Mexico's natural gas is open to private investment, as is the secondary petrochemical industry. Since the government's announcement in August 2001 that national and foreign private firms will be able to import liquefied petroleum gas duty-free, one LNG terminal has begun operation in Tamaulipas state, a second is under construction in Baja California, and CFE plans to build a third in Manzanillo, on Mexico's Pacific Coast.

Finance Public Works Contracts (COPFs), formerly Multiple Service Contracts (MSCs) designed to comply with the country's constitution, mark Mexico's most ambitious effort to attract private companies to stimulate natural gas production by developing non-associated natural gas fields. Under a COPF contract, private companies will be responsible for 100 percent of the financing of a contract and will be paid for the work performed and services rendered. However, the natural gas produced in a specific field remains the property of Pemex. Examples of work that contractors can

perform include seismic processing and interpretation, geological modeling, fields engineering, production engineering, drilling, facility design and construction, facility and well maintenance, and natural gas transportation services. Some Mexican politicians still oppose COPFs as a violation of the Mexican constitution's ban on concessions. Some contracts have failed to attract any bids, demonstrating the limited success of COPFs.

Telecommunications

Mexico allows up to 49 percent FDI in companies that provide fixed telecommunications networks and services. This includes the Cable TV (CATV) industry, with one exception: companies can issue Neutral or "N" stocks up to 99 percent, which can be owned by a foreign company. In fact, one CATV company operates under this ownership scheme. There is no limit on FDI in companies providing cellular/wireless services. However, Telmex and Telcel (America Movil continue to reign as the dominant telecom fixed and wireless powers and wield significant influence over key regulatory and government decision makers. Mexico's dominant landline and wireless carriers are traded on the New York Stock Exchange.

Several large U.S. and international telecom companies are active in Mexico, partnering with Mexican companies or holding minority shares. Following a 2004 WTO ruling, international resellers are authorized to operate in Mexico and some companies are also looking to sell wholesale minutes to resellers. Telcel (technically independent, but majority owned by Telmex owner's Grupo Carso - Carso Global Telecom) still retains a majority share (about 75 percent) of the cellular market. However, Spain's Telefonica Movistar, among others, continues to grow and challenge the status quo. They have deployed extensive mobile infrastructure to increase coverage across the country. ;

Telmex continues to dominate the market in Long Distance (local and international), Internet access through DSL, and bundle services. The Convergence Accord, published in October 2006, allowed Telmex to offer broadcasting or TV services.; However, the Federal Telecommunications Commission ruled that Telmex must first comply with interconnection, interoperability and number portability requirements before receiving permission to complete its triple-play offering. The accord has elicited strong concerns from the CATV industry, which fears that it will push CATV operators to consolidate. Under the accord, CATV operators (including TV duopolist Televisa's Cablevision) are allowed to independently offer Triple Play Service (VoIP-Telephony, Data-Internet and TV-Video), which might increase competition in the telephony market.

As in telecommunications, there are concerns that the two dominant television companies - Televisa and TV Azteca, who share duopoly status in the sector - continue to exercise influence over Mexican judicial, legislative and regulatory

bodies to prevent competition. However, in August 2007 the Mexican Supreme Court ruled against the most blatant anti-competition measures of the April 2006 Radio and Television Law. Among other decisions, the Court ruled that it was unfair for broadcasting companies to keep and use at no cost analog spectrum freed from the digitalization process. Currently the Mexican Legislature is working on a new media law based on the Supreme Court's ruling.
;
U.S. firms remain unable to penetrate the Mexican television broadcast market, despite the fact that both Televisa and TV Azteca benefit from access to the U.S. market.

Real Estate

Investment restrictions still prohibit foreigners from acquiring title to residential real estate in so-called "restricted zones" within 50 kilometers (approximately 30 miles) of the nation's coast and 100 kilometers (approximately 60 miles) of the borders. In all, the restricted zones total about 40 percent of Mexico's territory. Nevertheless, foreigners may acquire the effective use of residential property in the restricted zones through the establishment of a 50-year extendible trust (called a fideicomiso) arranged through a Mexican financial institution that acts as trustee.

Under a fideicomiso the foreign investor obtains all rights of use of the property, including the right to develop, sell and transfer the property. Real estate investors should, however, be careful in performing due diligence to ensure that there are no other claimants to the property being purchased. Fideicomiso arrangements have led to legal challenges in some cases. U.S. issued title insurance is available in Mexico and a few major U.S. title insurers have begun operations here. Additionally, U.S. lending institutions have begun issuing mortgages to U.S. citizens purchasing real estate in Mexico.

Transport

The Mexican government allows up to 49 percent foreign ownership of 50-year concessions to operate parts of the railroad system, renewable for a second 50-year period. The Mexican Foreign Investment Commission and the Mexican Federal Competition Commission (CFC) must approve ownership above 49 percent. In a positive sign for competition, the CFC recently struck down a proposed merger between two of the three major railroad companies.; The decision has been appealed.; Consistent with NAFTA, foreign investors from the U.S. and Canada are now permitted to own up to 100 percent of local trucking and bus companies, however, several companies have encountered long wait times and legal tie-ups when trying to obtain permits.

CINTRA, the government holding company for the Mexican airline groups, Mexicana and Aeromexico, sold Grupo Mexicana to Grupo Posadas in December 2005.; Grupo Aeromexico was sold to a consortium led by Citibank-owned Banamex in October ¶2007. The emergence of low-cost domestic airlines such as Volaris, Click Mexicana, and Interjet have increased competition and led to lower prices. However, foreign ownership of Mexican airlines remains capped at 25 percent. Foreign ownership in airports is limited to 49 percent. ;Foreign express delivery service companies continue to complain that Mexican legislation unfairly favors Mexican companies by restricting the size of trucks international carriers are allowed to use.;

Infrastructure

Mexican infrastructure investment, with certain previously noted exceptions, is open to foreign investment. The Mexican government has been actively seeking an increase in private involvement in infrastructure development in numerous sectors, including transport, communications, and environment. Improvement in the national infrastructure is seen as a key element in strengthening economic competitiveness and attracting investment to disadvantaged regions of the country. In July 2007, President Calderon presented the National Infrastructure Program 2007-2012 a key aspect of which is an increase in private investment through means of Service Lending Projects (public-private

partnerships) and concessionary schemes. The Office of the President provides an English language copy of the plan at: www.infraestructura.gob.mx.

Conversion and Transfer Policies

Mexico has open conversion and transfer policies as a result of its membership in NAFTA and the OECD. In general, capital and investment transactions, remittance of profits, dividends, royalties, technical service fees, and travel expenses are handled at market-determined exchange rates. Peso/dollar foreign exchange is available on same-day, 24- and 48-hour settlement bases. Most large foreign exchange transactions are settled in 48 hours. In June 2003, the U.S. Federal Reserve Bank and the Bank of Mexico announced the establishment of an automated clearinghouse for cross-border financial transactions. The International Electronic Funds Transfer System (TEFI) began operating in 2004 and commissions on transfers through the system have dropped rapidly.

Expropriation and Compensation

Under NAFTA, Mexico may not expropriate property, except for a public purpose and on a non-discriminatory basis. Expropriations are governed by international law, and require rapid fair market value compensation, including accrued interest. Investors have the right to international arbitration for violations of this or any other rights included in the investment chapter of NAFTA.

There have been twelve arbitration cases, of which two are still pending, filed against Mexico by U.S. and Canadian investors who allege expropriation, and other violations of Mexico's NAFTA obligations. Details of the cases can be found at the Department of State Website, Office of the Legal Advisor (www.state.gov/s/l).

Dispute Settlement

Chapter Eleven of NAFTA contains provisions designed to protect cross-border investors and facilitate the settlement of investment disputes. For example, each NAFTA Party must accord investors from the other NAFTA Parties national treatment and may not expropriate investments of those investors except in accordance with international law.

Chapter Eleven permits an investor of one NAFTA Party to seek money damages for measures of one of the other NAFTA Parties that allegedly violate those and other provisions of Chapter Eleven. Investors may initiate arbitration against the NAFTA Party under the Arbitration Rules of the United Nations Commission on International Trade Law ("UNCITRAL Rules") or the Arbitration (Additional Facility) Rules of the International Center for Settlement of Investment Disputes ("ICSID Additional Facility Rules"). Alternatively, a NAFTA investor may choose to use the registering country's court system.

The Mexican government and courts recognize and enforce arbitral awards. The Embassy has heard of no actions taken in the Mexican courts for an alleged Chapter 11 violation on behalf of U.S. or Canadian firms.

There have been numerous cases in which foreign investors, particularly in real estate transactions, have spent years dealing with Mexican courts trying to resolve their disputes. Often real estate disputes occur in popular tourist areas such as the Yucatan. American investors should understand that under Mexican law many commercial disputes that would be treated as civil cases in the U.S. could also be treated as criminal proceedings in Mexico. Based upon the evidence presented a judge may decide to issue arrest warrants. In such cases Mexican law also provides for a judicial official to issue an "amparo" (injunction) to shield defendants from arrest. U.S. investors involved in commercial disputes should therefore obtain competent Mexican legal counsel, and inform the U.S. Embassy if arrest warrants are issued.

Performance Requirements and Incentives

The 1993 Foreign Investment Law eliminated export

requirements (except for maquiladora industries), capital controls, and domestic content percentages, which are prohibited under NAFTA. Foreign investors already in Mexico at the time the law became effective could apply for

cancellation of prior commitments. Foreign investors who failed to apply for the revocation of existing performance requirements remained subject to them.

The Mexican federal government has eliminated direct tax incentives, with the exception of accelerated depreciation. A fiscal reform package was passed in September 2007 that includes a Flat Rate Corporate Tax (IETU). This tax limits the deductions that companies are allowed, though changes made at the behest of the business community still allow some credits for previous inventories and investments, as well as for companies that fall under the maquiladora scheme. Investors should follow IETU developments closely.

Most taxes in Mexico are federal; therefore, states have limited opportunity to offer tax incentives. However, Mexican states have begun competing aggressively with each other for investments, and most have development programs for attracting industry. These include reduced price (or even free) real estate, employee training programs, and reductions of the 2 percent state payroll tax, as well as real estate, land transfer, and deed registration taxes. Four northern states - Nuevo Leon, Coahuila, Chihuahua and Tamaulipas - have signed an agreement with the state of Texas to facilitate regional economic development and integration. Investors should consult the Finance, Economy, and Environment Secretariats, as well as state development agencies, for more information on fiscal incentives. Tax attorneys and industrial real estate firms can also be good sources of information.

U.S. Consulates have reported that the states in their consular districts have had to modify their incentive packages due to government decentralization. Many states have also developed unique industrial development policies. Sonora, for example, is working to expand the free entry area for tourists (south from the border to the port of Guaymas.) Sonora is one state that has implemented long-term agriculture and infrastructure development plans. The government of Yucatan provides information and support to potential investors and business entrepreneurs through several programs that target different industries such as technology, agroindustry and energy exploration. Several states are competing to attract manufacturing in the aerospace industry.

There is a government-owned development bank, Nacional Financiera, S.A. (www.nafin.com), which provides loans to companies in priority development areas and industries. It is active in promoting joint Mexican-foreign ventures for the production of capital goods. Nacional Financiera offers preferential, fixed-rated financing for the following types of activities: small and medium businesses; environmental improvements; studies and consulting assistance; technological development; infrastructure; modernization; and capital contribution. The Mexican Bank for Foreign Trade, Bancomext, offers a variety of export financing and promotion programs (www.bancomext.com).

Mexico has two programs to stimulate manufactured exports - maquiladora and PITEX (Program for Temporary Imports to produce Exports) - that largely operate in the same manner. The first is focused on companies that specialize in in-bond manufacturing and export, while the second is for companies that may have significant domestic sales. In November 2006, the maquiladora and PITEX programs were combined into the renamed IMMEX (Industria Manufacturera, Maquiladora y Servicios de Exportacion) program. The IMMEX program adds services, such as business process outsourcing, to the maquila scheme and also simplifies and streamlines the

processes under the two previous schemes. The new program continued to exempt companies from import duties and applicable taxes (e.g. VAT) on inputs and components incorporated into exported manufactured goods. In addition, capital goods and the machinery used in the production process are tax exempt, but are currently subject to import duties. Companies interested in investing in industrial activity in Mexico need to follow the new IMMEX guidelines closely, preferably in close consultation with locally based legal advisors. Please refer to the Secretariat of Economy's IMMEX program website at: http://www.economia.gob.mx/

In order to maintain competitiveness of maquiladora and PITEX companies and comply with NAFTA provisions, since 2001 Mexico has applied "Sectoral Promotion Programs" (PROSEC). Under these programs, most favored nation import duties on listed

inputs and components used to produce specific products are eliminated, or reduced to a competitive level. These programs comply with NAFTA provisions because import duty reduction is available to all producers, whether the final product is sold domestically or is exported to a NAFTA country. Currently there are 22 PROSECs, including electronics and home appliances, automotive and auto-parts, textile and apparel, footwear, and others. The lists of inputs and components incorporated under each PROSEC are not exhaustive, and the Mexican government regularly consults with industries to include more goods.

In the last three years the Secretariat of Economy conducted, in partnership with the private sector, 12 studies, called "Programs for Sectoral Competitiveness", of the country's most important sectors according to their levels of exports, employment and FDI. Studies covering the electronics, automotive, textile, maquiladora, leather and footwear, and software sectors are currently available at the website of the Secretary of Economy (http://www.economia.gob.mx/).

Right to Private Ownership and Establishment

Foreign and domestic private entities are permitted to establish and own business enterprises and engage in all forms of remunerative activity in Mexico, except those enumerated in Section 1 Table 1. Private enterprises are able to freely establish, acquire and dispose of interests in business enterprises. The two most common types of business entities are corporations (Sociedad Anonima) and limited partnerships (Sociedad de Responsibilidad Limitada). Under these legal entities a foreign company may operate an independent company, a branch, affiliate, or subsidiary company in Mexico. The rules and regulations for starting an enterprise differ for each structure.

Corporation (Sociedad Anonima)	Limited Liability Company (Sociedad de Responsibilidad Limitada)
Can be up to 100 percent foreign-owned.	Can be up to 100 percent foreign-owned.
Must have a minimum of 50,000 Mexican pesos in capital stock to start.	Must have a minimum of 3,000 Mexican pesos in capital stock to start.
Must have minimum of 2 shareholders, with no maximum. Board of Directors can run the administration of the company.	Must have a minimum of 2 partners to incorporate a corporation with limited liability. The partners must manage the company.
The enterprise has an indefinite life span.	Exists only while there is a business purpose and partners remain the same.

Free transferability of stock ownership is permitted.	Restricted transferability of partnership shares. Any changes in the partnership composition may cause the partnership to be liquidated.
Operational losses incurred by the Mexican entity or subsidiary may not be used by the U.S. parent company.	If structured properly, it may offer tax advantages by allowing operational losses incurred by the Mexican entity to be used by the U.S. parent company.
Limited liability to shareholders.	Limited liability is afforded to the partners.

Text continued in part 2.

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